No. 85-568

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

NANTAHALA POWER AND LIGHT COMPANY,
TAPOCO, INC., and
ALUMINUM COMPANY OF AMERICA,

Appellants,

v.

STATE OF NORTH CAROLINA, ex rel.
UTILITIES COMMISSION; LACY H. THORNBURG,
Attorney General, *et al,*

Appellees.

ON APPEAL FROM THE SUPREME COURT OF
NORTH CAROLINA

MOTION FOR LEAVE
TO FILE BRIEF
AS AMICUS CURIAE
and
BRIEF OF
NEW ENGLAND ELECTRIC SYSTEM
AS AMICUS CURIAE

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Pursuant to Rule 36.3, New England Electric System (NEES) respectfully moves this Court for permission to file the accompanying Brief as *Amicus Curiae*. The consent of the Appellants has been filed with the Court. The Appellees have withheld consent for the filing. NEES is a registered electric utility holding company under the Public Utility Holding Company Act of 1935, 15 U.S.C. §§79 *et seq.* The electric operations of its subsidiaries parallel the jurisdictional division between the Federal Energy Regulatory Commission and the state commissions. As a result, NEES has a significant and unique

interest in the jurisdictional conflict in this case. That interest may not be adequately presented by the Aluminum Company of America (Alcoa) and its subsidiaries because Alcoa's primary business is not as an electric utility and it is not subject to comprehensive regulation under the Holding Company Act, the Federal Power Act, and state utility law as are NEES and its subsidiaries. As the result of its intimate involvement with jurisdictional questions under the Federal Power Act, including the direct participation of its subsidiary in the decision in *Narragansett Elec. Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978), NEES can contribute to the Court's consideration of the Federal statutory preemption issues raised in this appeal.

For these reasons, NEES requests that it be granted leave to file the accompanying Brief as *Amicus Curiae*.

Respectfully submitted,

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STATEMENT OF INTEREST

New England Electric System (NEES) is interested in this case because the Federal Power Act's preemption of state jurisdiction over rates for wholesale electric sales is central to the regulation of NEES' electric utility subsidiaries.

NEES is a registered electric utility holding company system under the Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 *et seq.* Its subsidiaries provide electric service in New England. New England Power Company (NEP) provides the electric generation and transmission for three NEES retail companies that operate in different

states. Granite State Electric Company operates in New Hampshire, Massachusetts Electric Company in Massachusetts, and The Narragansett Electric Company in Rhode Island (together, the Retail Companies).

The activities of NEP and the Retail Companies parallel the jurisdictional division between the Federal Energy Regulatory Commission (FERC) and the state commissions. NEP sells power at wholesale to the Retail Companies under rates that are regulated by FERC under the Federal Power Act, 16 U.S.C. §§ 824 *et seq.*, and the Retail Companies resell the power to retail customers under rates regulated by the state commissions. If the decision by the North Carolina Supreme Court is upheld in this case, NEP and the Retail Companies will face dual regulation of the same costs and inconsistent regulatory obligations.

SUMMARY OF ARGUMENT

The North Carolina decisions in this case[1] are preempted by the Federal Power Act. Under the Federal Power Act, the Federal Energy Regulatory Commission (FERC) has jurisdiction over the sale of electricity at wholesale in interstate commerce. The sale of electricity by Nantahala Power & Light Company (Nantahala) to the Tennessee Valley Authority (TVA) is a sale of electricity at wholesale within the Federal Power Act. FERC has plenary jurisdiction of the rates, terms, and conditions of that sale as well as contracts that in any way relate to the sale. FERC's jurisdiction over the wholesale transaction is exclusive and states are preempted from regulating the transaction directly or indirectly.

State courts that have faced this question have consistently affirmed FERC's exclusive jurisdiction over wholesale sales, and have precluded state commissions in retail rate proceedings from questioning the

[1] The decisions by the North Carolina Supreme Court, the North Carolina Court of Appeals, and the North Carolina Utilities Commission are reproduced in the Appendix to the Jurisdictional Statement ("App.") at pages 1a, 141a, and 165a, respectively.

costs underlying wholesale rates. These state decisions apply squarely to this case. North Carolina has no jurisdiction to base Nantahala's retail rates on a cost allocation that is inconsistent with the FERC-filed New Fontana and 1971 Allocation Agreements. Rather, its exclusive avenue for challenging the Agreements was before FERC in accordance with the remedies in the Federal Power Act.

For these reasons, the decision of the North Carolina Supreme Court should be reversed.

ARGUMENT

I. UNDER THE FEDERAL POWER ACT, FERC HAS EXCLUSIVE JURISDICTION OVER THE NEW FONTANA AND 1971 ALLOCATION AGREEMENTS

At issue in this case is not the fairness of Nantahala's power supply arrangements with the TVA and Nantahala's affiliates. Rather, the issue centers on which commission, state or federal, has the jurisdiction to decide the fairness question. The resolution of the jurisdictional issue is governed by the following principles: (1) under the Federal Power Act, FERC has exclusive jurisdiction over wholesale sales of electricity in interstate commerce; (2) the New Fontana Agreement, under which Nantahala sells power to TVA, and the 1971 Allocation Agreement, which establishes Nantahala's consideration for the sale, are rates for the sale of electricity at wholesale in interstate commerce on file with FERC and subject to FERC's exclusive jurisdiction; (3) state regulatory commissions are preempted from indirectly regulating wholesale rates by reviewing in retail rate proceedings the reasonableness of the costs underlying those wholesale rates and adopting cost allocations at variance with their terms; and (4) North Carolina's exclusive avenue for challenging the wholesale rate was its intervention and complaint before FERC.

These principles have been established in a consistent line of decisions by this Court. They control this case. Because North

Carolina's allocation is inconsistent with the FERC-filed wholesale rate, it is preempted and unlawful.

A. FERC Has Jurisdiction over Wholesale Sales of Electricity in Interstate Commerce

Under § 201(b) of the Federal Power Act, FERC has jurisdiction over "the sale of electric energy at wholesale in interstate commerce. . . ." 16 U.S.C. § 824(b)(1).[2] Over the years, the grant of jurisdiction in § 201(b) has been broadly construed. The scope of the Act's preemptive effect under the Supremacy Clause of the Constitution now extends beyond the strict constitutional limits of the Commerce Clause.

This Court squarely addressed the scope of FERC's jurisdiction in *Federal Power Comm'n* v. *Southern Cal. Edison Co.*, 376 U.S. 205 (1964) (the "*City of Colton*" case).[3] In that decision, the Court

[2] The statute was enacted in response to this Court's 1927 decision in *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927). In the *Attleboro* case, the Court held that the states were barred by the Commerce Clause from regulating these interstate wholesale transactions. In 1935, Congress enacted Part II of the Federal Power Act to close the *Attleboro* gap and bring a uniform system of comprehensive Federal regulation to wholesale power transactions in interstate commerce. S. Rep. No. 621, 74th Cong., 1st Sess. 17 (1935).

[3] The *City of Colton* case arose when the Federal Power Commission (FERC's predecessor) asserted jurisdiction over a wholesale sale of electricity between two California utilities. The Court of Appeals reversed the Commission, relying on the language of § 201(a) of the Act that provides: "such Federal regulation, however, [is] to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a). The Court of Appeals reasoned that the intrastate wholesale transaction was subject to state regulation under the Commerce Clause as it had been construed in *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co., supra*, and that the state retained jurisdiction under the limiting language of § 201(a). This Court rejected the analysis, reversed the Court of Appeals, and affirmed the Commission.

held that the "clear and specific grant of jurisdiction" under § 201(b) of the Act does not depend on a "case-by-case analysis of the impact of state regulation upon the national interest" under the Commerce Clause. 376 U.S. 215.

> Rather, Congress meant to draw a *bright line easily ascertained*, between state and federal jurisdiction, making unnecessary such case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States.

376 U.S. 215-16 (emphasis supplied); *see also Federal Power Comm'n* v. *Florida Power & Light Co.*, 404 U.S. 453, 461, n. 10 (1972).

Thus, the scope of FERC jurisdiction under the Federal Power Act, and therefore of Federal preemption under the Supremacy Clause, does not depend on the constitutional limits on state action imposed by the Commerce Clause. The difference between the analyses under the Supremacy and Commerce Clauses was confirmed in *Arkansas Elec. Coop. Corp.* v. *Arkansas Public Serv. Comm'n*, 461 U.S. 375 (1983). In that case, the Court applied a current Commerce Clause analysis to affirm state regulation of a wholesale sale of electricity by a rural electric cooperative to local distribution cooperatives within the same state.[4] Because cooperatives are exempt from rate regulation under the Federal Power Act, these wholesale sales were not subject to FERC's jurisdiction. As the Court explained, if they were, "we would obviously be faced with a very different pre-emption question." 461 U.S. at 383, n. 7. In that event, "the wholesale rates would . . . be subject exclusively to federal regulation." 461 U.S. at 381.

[4] Specifically, the Court decided that the mechanistic Commerce Clause analysis in *Public Util. Comm'n* v. *Attleboro Steam & Elec. Co.*, 273 U.S. 83 (1927) was no longer appropriate. However, the Court reserved judgment on the result that would be produced under the Commerce Clause if the State action directly affected more than one state, as was the case in *Attleboro* and is the case here. *Arkansas Elec. Coop Corp.* v. *Arkansas Public Serv. Comm'n, supra*, 461 U.S. at 390, n. 16.

B. The New Fontana and 1971 Allocation Agreements Establish the Rates, Terms, and Conditions for an Interstate Wholesale Sale of Electricity under the Federal Power Act

This case involves a "sale of electric energy at wholesale in interstate commerce." § 201(b), 16 U.S.C. § 824(b). Under the New Fontana Agreement, Nantahala sold all of the electrical output of its hydro facilities to TVA. The 1971 Allocation Agreement established Nantahala's consideration for the sale. The entire transaction was an interstate sale of electric energy to TVA for resale by TVA within the meaning of the Federal Power Act. § 201(d), 16 U.S.C. § 824(d).

Under the Federal Power Act, FERC has jurisdiction over the entire transaction. FERC regulates not only the rates and charges received by Nantahala from TVA, but also all contracts, terms and practices that relate to the sale. Under § 205(c) of the Act, public utilities are required to file with FERC (16 U.S.C. § 824d(c)):

> Schedules showing all rates and charges for any transmission or sale subject to the jurisdiction of the Commission, and the classification, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

See also 18 C.F.R. § 35.2(b) (definition of "rate schedule" under FERC regulations).

FERC has a statutory responsibility under § 205(a) to assure that "all rates and charges made, demanded, or received by any public utility . . . and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable." 16 U.S.C. § 824d(a). Under § 206(a), the Commission must upon complaint "determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order." 16 U.S.C. § 824e(a). FERC thus has broad jurisdiction over all elements of the interstate wholesale transaction. FERC has exercised its jurisdiction over both the New Fontana and 1971 Allocation Agreements. Both have been filed with FERC. *See* App. pp. 263a-266a, 286a-287a, 298a-299a.

The "sale of electricity" by Nantahala to TVA distinguishes this case from the cost allocation theory used by the North Carolina Supreme Court to justify its roll-in. App. pp. 32a-72a. Cost allocations are typically required when a single utility provides service in two or more jurisdictions. Each Commission must establish the appropriate portion of the utility's costs devoted to its jurisdictional service. No wholesale sale of electricity occurs under the Federal Power Act, and FERC does not have jurisdiction over the cost allocation. In this case, however, a sale of electricity has occurred. The sale is subject to FERC's exclusive jurisdiction under §§ 201, 205, and 206 of the Federal Power Act. North Carolina may not apply a cost allocation at variance with the FERC-filed rates for the sale. *See Northern States Power Co.* v. *Minnesota Public Utils. Comm'n*, 344 N.W.2d 374 (Minn. 1984), *cert. denied* 104 S. Ct. 3546 (1984).

The distinction between cost allocations and wholesale sales was recognized by this Court in *Colorado Interstate Gas Co.* v. *Federal Power Comm'n*, 324 U.S. 581 (1944).[5] The case involved two companies — Canadian River Gas Company, a producer of natural gas, and Colorado Interstate Gas Company, a pipeline company that transported a major portion of Canadian's gas production from Texas to Colorado. Only a portion of the gas sales was subject to the Commission's jurisdiction under the Natural Gas Act. Thus, the Court was called upon to review both the Commission's cost allocation between jurisdictional and nonjurisdictional sales and the rates for the sale of gas from Canadian to Colorado Interstate.

[5] The *Colorado Interstate Gas Co.* case arose under the Natural Gas Act, 15 U.S.C. § 717 *et seq*. This Court has observed that the pertinent provisions of the Federal Power Act "are in all material respects substantially identical to the equivalent provisions of the Natural Gas Act." *Federal Power Comm'n* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956). Decisions under the two statutes are typically cited interchangeably. *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571, 577, n.7 (1981).

The Court first focused on the proper cost allocations between jurisdictional and nonjurisdictional sales under the Natural Gas Act (324 U.S. at 586-95). The Court explained that in the Natural Gas Act (324 U.S. at 589):

> Congress indeed prescribed no formula for determining how the interstate wholesale business, whose rates are regulated [by FERC], should be segregated from the other phases of the business whose rates are not regulated.

Accordingly, the cost allocation was deemed a question of judgment for the Commission "on a myriad of facts." *Id.* The Court concluded that the appropriateness of the allocation "raises questions of fact not of law" (324 U.S. at 590), and affirmed the Commission's allocation.

The Court then turned to the sale of gas by Canadian to Colorado Interstate for resale. 324 U.S. at 595-97. The sale was squarely within the Commission's jurisdiction. The utilities suggested that because the Commission's cost allocations were based on the operation of the two companies as an integrated system, the companies should be treated as a single entity for ratemaking purposes. Under this approach, there would be no wholesale sale between Canadian and Colorado Interstate. The suggestion was rejected by the Court (324 U.S. at 597):

> The difficulty is that Colorado Interstate purchases its gas from Canadian and the purchase price is the interstate wholesale rate which is an operating expense on which Colorado Interstate's resale rates are computed. Moreover, Canadian as required by § 4(c) of the Act has its rate to Colorado Interstate in a rate schedule on file with the Commission. Unless and until a new rate schedule was filed or the old schedule changed by the Commission, that rate would have to be exacted by Canadian and paid by Colorado Interstate. § 4(d).

In this case, Nantahala has made a wholesale sale to TVA. That sale is governed by the New Fontana and 1971 Allocation Agreements. Like the wholesale sale in the *Colorado Interstate* case, the rates fall squarely within FERC's jurisdiction under the Federal Power Act.

The FERC-filed rates must be recognized by North Carolina in retail rate proceedings.

C. FERC's Jurisdiction over the New Fontana and 1971 Allocation Agreements Is Exclusive

FERC's jurisdiction over Nantahala's sale to TVA is exclusive. A state may not intrude either directly or indirectly on any element of the FERC regulated transaction. This Court addressed the issue in *Northern Natural Gas Co.* v. *State Corp. Comm'n*, 372 U.S. 84 (1963). The Kansas Supreme Court had affirmed a state commission order requiring an interstate gas pipeline to modify purchase allocations from in-state gas producers on the ground that the State order did not affect the price of gas. This Court reversed, holding that (372 U.S. at 91-92, citations and footnote omitted):

> The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas, or for state regulations which would indirectly achieve the same result. These state orders necessarily deal with matters which directly affect the ability of the Federal Power Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act. They therefore invalidly invade the federal agency's exclusive domain.

Thus, it is unimportant that the North Carolina court found that its decision did not change Nantahala's wholesale rates. App. p. 76a. The North Carolina decision was based on a detailed investigation of the New Fontana and 1971 Allocation Agreements that govern a wholesale sale of electricity subject to FERC's exclusive jurisdiction. The North Carolina allocation was flatly inconsistent with the FERC-filed rate. Like the attempted allocations in *Northern Natural Gas* (372 U.S. at 91-92), North Carolina's roll-in decision directly affects the ability of FERC "to regulate comprehensively and effectively the [transmission] and sale of [electricity], and to achieve the uniformity of regulation which was an objective of the [Federal Power Act]."

Nor can the North Carolina decision be justified as an appropriate exercise of its authority under state utility law. *See* App. pp. 77a-

80a, 88a-89a. The Federal Power Act preempts inconsistent state action regardless of the source of authority. State courts are preempted from affecting FERC filed rates by awarding damages under state contract law, *Arkansas Louisiana Gas Co.* v. *Hall*, 453 U.S. 571 (1981), and state legislatures are preempted from affecting wholesale rates under their taxing powers. *Exxon Corp.* v. *Eagerton*, 462 U.S. 176, 184-86 (1983); *Maryland* v. *Louisiana*, 451 U.S. 725, 751-52 (1981). As the Court found in *Arkansas Louisiana Gas Co.* v. *Hall*, *supra*, 453 U.S. at 584:

> When a court is called upon to decide whether state and federal laws are in conflict, the fact that state law has been violated does not affect the analysis. Every pre-emption case involves a conflict between a claim of right under federal law and a claim of right under state law. A finding that federal law provides a shield for the challenged conduct will almost always leave the state law violation unredressed.

In this case, both North Carolina and FERC asserted jurisdiction to investigate the same wholesale transactions. The fact that North Carolina came to a different result under state law cannot control. "Congress here has granted exclusive authority over rate regulation to [FERC]" and "when Congress has established an exclusive form of regulation, 'there can be no divided authority over interstate commerce.'" 453 U.S. at 580.

Finally, the affiliate relationship between Nantahala, Tapoco, and Alcoa does not affect the jurisdictional analysis under the Federal Power Act. The Federal Power Act was passed as a direct response to the growth in public utility holding companies. One of the express purposes of Congress when enacting Part II of the Federal Power Act was to bring wholesale electric sales among affiliates under effective national control. S. Rep. No. 621, 74th Cong., 1st Sess. 17-18 (1935).[6]

[6] The Senate Report found that (S. Rep. No. 621, p. 17):

> In recent years the growth of giant holding companies has been paralleled by the rapid development of the electric industry along lines that transcend state boundaries. To a great extent through the agency of the holding company, local operating units have been tied together into vast interstate systems.
>
> * * *
>
> The new part 2 of the Federal Water Power Act would be the first assertion of Federal jurisdiction over this major interstate public utility.

Part II of the Federal Power Act was enacted together with the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 *et seq.*, as a single coordinated piece of legislation. The Public Utility Act, Pub. L. No. 74-333, 49 Stat. 803 (1935). The Holding Company Act provides in Section 13 for regulation of transactions between affiliates by the Securities and Exchange Commission. 15 U.S.C. § 79m; Conference Report on Public Utility Act of 1935, House Report No. 1903, 74th Cong., 1st Sess. 71-72 (1935). Expressly excluded from the coverage of Section 13, however, are wholesale sales of electric energy between affiliates. Section 2(a)(20), 15 U.S.C. § 79b(a)(20). These wholesale sales were simultaneously subjected to plenary rate regulation by the Federal Power Commission under Part II of the Federal Power Act. Thus, Congress intended FERC to be the exclusive arbiter of the reasonableness of interstate wholesale transactions between affiliates.

The legislative history confirms this conclusion. Congress focused sharply on the absence of arm's length bargaining between affiliates and the states' practical inability to regulate these transactions. *E.g.*, S. Rep. No. 621, 74 Cong., 1st Sess. 36, 56-57 (1935). Previously recognized state authority over interstate affiliate transactions was referred to as "purely theoretical." Hearing on H.R. 5423 before House Comm. on Interstate and Foreign Commerce, 74th Cong., 1st Sess. 761 (1935).[7] When enacting the Federal Power Act, Congress not only closed the *Attleboro* gap, but also addressed other features

[7] Prior to the passage of the Holding Company Act and the Federal Power Act, the Court decided, in *Western Distributing Co.* v. *Public Service Commission*, 285 U.S. 119 (1932), that a state commission could constitutionally review the costs underlying the otherwise unregulated wholesale rates of its affiliate in a retail rate proceeding. In that case, the Court noted the potential for abuse caused by transactions controlled by neither market forces nor regulation. Congress eliminated this potential when it closed the *Attleboro* gap and brought wholesale rates under effective and exclusive federal control. See n.1, *supra*. The fact that Congress did not preserve the state's "purely theoretical" authority over wholesale costs underlying transactions between affiliates is consistent with Congress' overall approach to the Federal Power Act. Congress did not in the Act apportion regulatory authority between the states and the federal government along strict constitutional lines. *See City of Colton*, *supra*, 376 U.S. at 215-16.

of the interstate utility business that were "equally immune from state control either legally or practically." S. Rep. No. 621, *supra*, p. 17. Thus, Congress brought all wholesale sales of electricity, including wholesale sales between affiliates, under effective and exclusive federal regulatory control. The North Carolina Supreme Court decision undermines this carefully crafted federal scheme. Its concerns over reasonable rates and affiliate transactions were addressed directly by Congress in the Federal Power Act, and when the "Federal scheme . . . aims precisely at the same ends as does" the state regulation, the state regulation must fall. *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151, 165 (1978).

In short, Nantahala's sales of electric energy to TVA are "wholesale sales in interstate commerce" under the Federal Power Act. The New Fontana and 1971 Allocation Agreements by which these sales are implemented are subject to FERC's plenary authority under Sections 205 and 206 of the Act. Since these Agreements were accepted for filing as wholesale rates and allowed to take effect by FERC, they establish the only legal price that can be received by Nantahala for its sales to TVA. *Montana-Dakota Util. Co.* v. *Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951). North Carolina is preempted from changing them in a retail rate proceeding.

II. State Courts Have Confirmed FERC's Exclusive Jurisdiction over Wholesale Rates

Not only does North Carolina lack direct jurisdiction over the wholesale rates, it cannot assert jurisdiction over the rates indirectly by examining the reasonableness of the New Fontana and 1971 Allocation Agreements in a retail rate proceeding and approving a cost allocation at variance with the FERC filed rate schedules. The "bright line" established by Congress contemplates that FERC has the exclusive responsibility for assuring that interstate rates and contracts are just and reasonable. 16 U.S.C. § 824d; *City of Colton*, *supra*. The Federal Power Act and this Court's decisions make clear that Congress did not set up an elaborate federal regulatory process for consideration of wholesale rates, only to have state commissions consider the very same issues in retail rate proceedings. *Northern Natural Gas Co.* v. *State Corp. Comm'n*, *supra*. For this reason, state courts have consistently held that state commissions are preempted from investigating the costs underlying wholesale rates in retail rate cases.[8]

A. The *Narragansett* Doctrine Precludes a State Commission in a Retail Rate Proceeding from Investigating the Costs Underlying Wholesale Rates

The leading case is *Narragansett Elec. Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied* 435 U.S. 972 (1978). Narragansett, a retail utility, buys all of its power requirements at wholesale from its affiliate NEP under rates regulated by FERC. NEP had filed with FERC an increase in its wholesale rate to Narragansett. The controversy was triggered when Narragansett filed with the Rhode Island Commission to recover from retail customers the increased purchased power expense under the FERC-filed rate. Acting under its authority to regulate affiliate transactions under state law, the Rhode Island Commission investigated in Narragansett's retail rate proceeding the reasonableness of the costs underlying NEP's wholesale rate filing with FERC. The Commission disallowed from retail rates those costs underlying NEP's wholesale filing that it considered "'strikingly' or 'glaringly' unreasonable." *Narragansett*, *supra*, 381 A.2d at 1361.

The Rhode Island Supreme Court reversed. It began by identifying the "bright line" set forth in the *City of Colton* case and found that under the Federal Power Act:

> The result is a blend of state-federal regulation, each with exclusive authority in its respective field. We conclude, therefore, that

[8] *E.g. Narragansett Elec. Co.* v. *Burke*, 119 R.I. 559, 381 A.2d 1358 (1977), *cert. denied*, 435 U.S. 972 (1978); *Northern States Power Co.* v. *Minnesota Pub. Serv. Comm'n*, 344 N.W.2d 374 (Minn. 1984), *cert. denied*, 104 S. Ct. 3546 (1984); *Eastern Edison Co.* v. *Department of Pub. Utils.*, 388 Mass. 292, 446 N.E.2d 684 (1983); *Washington Gas Light Co.* v. *Public Serv. Comm'n*, 452 A.2d 375 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983); *Northern States Power Co.* v. *Hagen*, 314 N.W.2d 32 (N.D. 1981); *Public Serv. Co. of Colorado* v. *Public Utils. Comm'n*, 644 P.2d 933 (Colo. 1982).

jurisdiction to determine the reasonableness of the wholesale rate charged by NEPCO to Narragansett rests exclusively with FERC.

The Court then turned to the Commission's responsibility to allow recovery of reasonable expenses under state law, including reasonable purchased power expense. Citing *Montana-Dakota Util. Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951), the Court concluded that the FERC-filed rate was reasonable as a matter of law. *See also Arkansas Louisiana Gas Co.* v. *Hall, supra*. Thus, the Rhode Island Court held (381 A.2d at 1363):

> that for the purpose of fixing intrastate rates, the PUC must treat NEPCO's R-10 interstate rate filed with the FPC as a reasonable operating expense. Narragansett has met the burden of proof [under state law] by establishing that the price of the contract with its affiliate is the FPC filed and effective rate.

Accordingly, the Rhode Island Court required the State Commission to accept as reasonable Narragansett's purchased power expense under the FERC-filed rate.

The Court looked to state law only for the procedure to be used when reflecting the wholesale power costs in Narragansett's retail rates. Specifically, the Court found that the Commission could suspend Narragansett's retail filing and "investigate the overall financial structure of Narragansett to determine whether the company has experienced savings in other areas which might offset the increased price for power." 381 A.2d at 1363. The key point is that the wholesale rate must be accepted as a reasonable operating expense regardless of the procedure used to reflect that expense in retail rates.

The rationale of the Rhode Island Court has been applied consistently in other states.[9] Those decisions preclude the state commission from crossing the bright line, and investigating the reasonableness of the costs that underlie the FERC-filed wholesale rate. Although the state court holdings recognize procedural flexibility on the part of local

[9] The only state court exception to the *Narragansett* doctrine originated in a decision by a Pennsylvania intermediate appellate court in *Pike County Light & Power Co.* v. *Pennsylvania Public Util. Comm'n*, 77 Pa. Commw. 268, 465 A.2d 735 (1983). In that case, the Pennsylvania Commission had disallowed a portion of Pike County's purchased power expense, not because the costs underlying the wholesale rate were unreasonable, but on the ground that Pike County could have purchased the power from an alternative supplier more cheaply. The Pennsylvania Commission concluded that Pike County's decision to contract for the purchase under the wholesale rate was imprudent and the Court affirmed. Because the state Commission did not focus on the wholesale utility's costs but only on the retail utility's prudence in incurring those costs, the Court found that the Commission's disallowance was an appropriate exercise of retail ratemaking. *See also Appeal of Sinclair Machine Products, Inc.*, N.H. , 498 A.2d 696 (1985).

The *Pike County* rationale does not apply to this case for the simple reason that the dispute in this case centers on Nantahala's rates for a sale of power to TVA. No one has argued that FERC lacks jurisdiction to investigate the prudence of a seller's rates under the Federal Power Act.

But *Pike County* should not be followed for a more fundamental reason. The decision is based on an incorrect reading of FERC's jurisdiction and responsibilities under the Federal Power Act. As explained above, the Federal Power Act gives FERC jurisdiction over the "sale" of electricity at wholesale in interstate commerce. Under the Act, FERC must establish "just and reasonable" rates for that sale. Nothing in the Act says that the rates shall be "just and reasonable" only for the seller. Quite the contrary, this Court has uniformly endorsed FERC's responsibility to purchasers and to the public interest in general. *Federal Power Comm'n* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603, 610-18 (1944); *Federal Power Comm'n* v. *Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956). For example, FERC must examine the purchaser's alternatives to the wholesale rates as part of its responsibilities to prevent price squeezes and other anticompetitive effects. *Federal Power Comm'n* v. *Conway Corp.*, 426 U.S. 271 (1976). Finally, the statute and legislative history demonstrate that Congress intended to provide effective and comprehensive regulation of both affiliate sales and purchases at the wholesale level. See text accompanying notes 6 and 7; Hearings on H.R. 5423, *supra*, at 760-61. Thus, FERC is the proper and exclusive forum to litigate the justness and reasonableness of wholesale rates from the perspective of both buyers and sellers.

Contrary to the *Pike County* decision, FERC's jurisdiction attaches to the transaction, not just the selling party in the transaction. As this Court found in *Northern Natural Gas Co.* v. *State Corp. Comm'n*, *supra*, 372 U.S. at 91, FERC has exclusive jurisdiction over "all wholesales . . . in interstate commerce . . . whether occurring before, during, or after transmission" in interstate commerce.

commissions to select the manner in which the wholesale power costs are reflected in retail rates, they are premised on the conclusion that state commissions may not challenge the costs underlying FERC-filed wholesale rates in a retail rate proceeding.

The recognition by these courts of complete federal preemption over both wholesale rates and the costs underlying those wholesale rates is correct. Any other approach would result in chaos. If states had authority to independently review costs underlying wholesale rates, utilities and customers would litigate these costs before FERC, and then turn around and start all over before state agencies. Everyone would take two full bites of the apple. The result would be gaps and potential double recovery. FERC would establish its policy for cost recovery on an issue for wholesale rates subject to its jurisdiction, and state ratemaking authorities would establish their own policies *for the very same costs*. The result would be confusion and truly ineffective regulation.

Of course, Congress did not intend this result, and it did not incorporate it in the Federal Power Act. Rather, as the Court found when reviewing the parallel provisions in the Natural Gas Act in *Panhandle Eastern Pipe Line Co.* v. *Public Serv. Comm'n*, 332 U.S. 507, 520 (1947), Congress:

> created an articulate legislative program based on a clear recognition of the respective responsibilities of the federal and state regulatory agencies. It [did] not contemplate ineffective regulation at either level.

Instead, Congress drew the "bright line easily ascertained, between state and federal jurisdiction" found in the *City of Colton* case.

B. The Narragansett Doctrine Applies Squarely to this Case

The *Narragansett* doctrine applies directly to this case. FERC has exclusive jursidiction over Nantahala's sale of power to TVA and the consideration that it receives for that sale under the 1971 Allocation Agreement. The Agreements have been filed with and allowed to

become effective by FERC. They establish the only lawful consideration that Nantahala can receive for its sales to TVA. These Agreements must be accepted as reasonable by the North Carolina Commission when setting retail rates.

The North Carolina Court attempted to distinguish the application of these principles on two grounds. First, it simply misread the *Narragansett* line of cases. App. pp. 81a-84a.[10] As explained, those cases look to state law only for the purpose of determining the procedure by which the FERC-filed rate is to be reflected in retail rates. The North Carolina Court converted this limited discretion into the broad proposition that (App. p. 84a):

> a state commission retains the discretion to do exactly what the Commission has done in the instant case: determine that certain of a utility's costs were effectively incurred for the benefit of its shareholder, not its retail consumers, and therefore should be borne by the shareholder, and not by the utility's retail rate payers.

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[10] The North Carolina Court's discussion of *Public Serv. Co. of Colo.* v. *Public Utils. Comm'n*, 644 P.2d 933 (1982) and *Washington Gas Light Co.* v. *Public Serv. Comm'n*, 452 A.2d 375, 384-86 (D.C. App. 1982), *cert. denied* 462 U.S. 1107 (1983) illustrates the problem. App. 82a-83a. The Colorado decision parallels the Narragansett decision exactly. Like the Rhode Island court, the Colorado court held that the Commission was required to treat the costs under the wholesale rate as reasonable operating expenses for retail ratemaking purposes (644 P.2d 937-40) and that the Commission had the discretion to determine the procedure used to reflect these costs in retail rates. It therefore affirmed the Commission's decision to consider the expenses in a full rate case rather than an automatic rate adjustment.

The North Carolina reading of the *Washington Gas Light Co.* decision is more egregious. App. pp. 83a-84c. Under the North Carolina Court's interpretation of a footnote, the decision gave the local commission discretion to disallow costs under wholesale rates. See 452 A.2d at 385, n. 15. The holding in *Washington Gas Light Co.* is as follows (452 A.2d at 386) (emphasis supplied):

> We hold that the Commission had no authority to disallow as a reasonable operating expense the wholesale purchase cost of natural gas approved by FERC . . . . Because we hold that the Commission had no jurisdiction to rule on the reasonableness of such surcharges, we need not reach, and the *Commission was unauthorized to consider, the issue of whether the GRI charges benefit the District of Columbia ratepayers.*

The *Narragansett* line of cases stands for precisely the opposite conclusion. Those decisions establish that FERC has exclusive jurisdiction to determine whether a utility's wholesale power costs were incurred for shareholders or customers, and the State has neither jurisdiction nor discretion to decide the issue. Contrary to the North Carolina Court's conclusion, the *Narragansett* line of cases recognizes that the state commission must by law accept the wholesale power costs under a FERC-filed rate as a reasonable operating expense in retail rate proceedings.

The second distinction suggested by the North Carolina Court is based on the actions taken by FERC in a Nantahala wholesale rate proceeding. App. pp. 91a-98a. In that proceeding, FERC found the New Fontana Agreement to be reasonable (App. pp. 293a-95a), but adopted a different cost allocation for Nantahala's wholesale customers than the one specified in the 1971 Allocation Agreement. App. pp. 295a-98a. At the same time, FERC declined to reform the 1971 Allocation Agreement. App. p. 298a. The FERC decisions were affirmed on appeal. *Nantahala Power & Light Co.* v. *FERC*, 727 F.2d 1342 (4th Cir. 1984).

FERC's decision not to reform the 1971 Allocation Agreement that it found to be unfair should not obscure the fact that FERC retains exclusive jurisdiction over both Agreements. The exclusive remedy for North Carolina remains at FERC. This remedy must be pursued within the framework of the Federal Power Act. FERC's jurisdiction does not turn on its ultimate decision. If error exists, it must be pursued before the regulatory agency with the authority to correct it. *See Massachusetts* v. *United States*, 729 F.2d 886 (1st Cir. 1984). FERC's decisions give no license to North Carolina to cross the bright line, go beyond its jurisdictional limits, and "trespass on the authority of the federal agency." *Maryland* v. *Louisiana*, *supra*, 451 U.S. at 751. The North Carolina decision does just that. It should be reversed.

CONCLUSION

For the reasons stated, the decision of the North Carolina Supreme Court should be reversed.

Respectfully submitted,

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